

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

GRANT CREEK INN, LLC,)	
d.b.a., BEST WESTERN GRANT)	
CREEK INN,)	
)	DOCKET NO.: PT-1997-84
Appellant,)	
)	
-vs-)	
)	FINDINGS OF FACT,
THE DEPARTMENT OF REVENUE)	CONCLUSIONS OF LAW,
OF THE STATE OF MONTANA,)	ORDER and OPPORTUNITY
)	<u>FOR JUDICIAL REVIEW</u>
Respondents.)	

The above-entitled appeal was heard on the 7th day of August, 1998 in the City of Missoula, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was given as required by law.

The taxpayer, represented by Gregory A. Damico, CPA, and Larry McRae, managing partner, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by appraiser Patrick McKenna and appraisal supervisor Jim Fairbanks, presented evidence in opposition to the appeal. Testimony was presented, exhibits were received, a post-hearing submission schedule was determined, post-hearing submissions were received, and the Board then took the cause under advisement; and the Board having fully considered the testimony, exhibits and all things and matters presented to it,

finds and concludes as follows:

FINDINGS OF FACT

1. Due, proper and sufficient notice was given of this matter, the hearing, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. The subject property is the Grant Creek Inn and is described as follows:

Lot 5, Towne Center Addition, City of Missoula, Missoula County, State of Montana; Assessor Code #04-2200-05-3-03-02-0000.

3. The DOR appraised the subject property at a value of \$297,040 for the land and \$5,633,600 for the improvements.

4. On December 12, 1997, the taxpayer appealed to the Missoula County Tax Appeal Board (MCTAB) requesting values of \$297,040 for the land and \$3,800,000 for the improvements, stating:

Income & cost approaches do not support reappraised value. Please see supporting schedules attached.

5. In a decision dated January 23, 1998, the MCTAB denied the appeal, stating:

The appellant's burden to disprove the DOR's building valuation was not met. The \$5,633,600 value is hereby sustained (by split decision).

6. The taxpayer appealed that decision to this Board on February 10, 1998, stating:

1997 re-appraised value is not supported by the market as indicated by both actual costs of construction and the income approach to value.

7. At the hearing before this Board the taxpayer revised the requested value for the improvements to \$4,644,000.

Then Mr. Damico further revised that value to \$4,664,000 as a result of reviewing the actual construction costs contained within exhibit #2 during his direct testimony, he realized the figures had been transposed.

8. The Grant Creek is a limited-service hotel which opened for operation in May of 1996. There are 126 rooms and banquet facilities but no restaurant or lounge.

9. The post-hearing submission requested by the Board allowed each party an opportunity to provide additional evidence to support their respective capitalization rates.

10. Mr. Damico represents various motel/hotel operators in this series of appeals; therefore, the Board will take administrative notice of the evidence and testimony presented in PT-1997-82, PT-1997-83, PT-1997-85 & PT-1997-86.

TAXPAYER-S CONTENTIONS

Mr. McRea testified the partnership began analyzing the motel/hotel industry within the Missoula area in the early 1990s. When construction began on the subject property, it was discovered that four similar projects were in various stages of planning and construction. Missoula had 35 lodging

facilities containing 2,047 rooms and was being increased by five new facilities with an additional 390 rooms, an increase of approximately 20% in the inventory.

Mr. McRea testified that one way to analyze the hotel/motel industry in an area is by what is called ~~A~~revpar.¹ Revpar is calculated by taking the number of rooms in the community multiplied by 365 days in the year and then dividing the result by the revenue generated by those properties. Revpar for Missoula was approximately \$26.83 in 1995 versus \$23.28 in 1996, a decrease of approximately 13%.

Montana has a 4% bed tax. Missoula's bed tax collections in 1995 were \$802,000 and, in 1996, bed tax collections increased to \$828,000. In 1997 bed tax collections declined to \$797,383. Mr. McRea testified that bed tax collections are a matter of public record. Tax collections for years 1996 and 1997 are illustrated on exhibit #1, page 2.

Mr. McRea testified that, while there has been an increase in the room inventory, there has not been an improvement in the market conditions. There are many factors that affect market conditions and one major factor that has affected the Missoula hotel/motel industry has been the decline in the Canadian economy.

¹Revpar revenue is that room revenue which is subject to the State of Montana's ~~A~~Bed Tax~~@~~.

Mr. McRea testified the partnership's analysis of the Missoula market was during the years 1993 and prior. In 1994 the market began to flatten out, but the numbers still reflected growth potential. Grant Creek Inn, LLC had no business ties with any of the four new lodging facilities which were developed during the same time frame. Mr. McRea stated that developers of these types of properties are ~~A~~closed-mouthed.@"

Mr. McRea testified that the Grant Creek has had to modify its rates during the off-season, and rates are not at the level originally anticipated.

Mr. McRea testified to an occupancy percentage of 51% for the year 1997 for the subject property. A national average for a property of this type is in the range of 60% to 65%. The anticipated occupancy rate for the first year was 60% and over a five year period was anticipated to reach 68%.

Mr. McRea testified there are market segments within the hotel/motel industry, and Grant Creek's direct competitors are the Hampton Inn, the Holiday Inn, the Double Tree Inn (originally the Red Lion Inn), and the Holiday Express.

Mr. Damico presented the Board with the construction costs for the improvements which totaled of \$4,664,186 (ex #2, pg. 2), rounded to \$4,664,000 which is the value requested by the taxpayer. Mr. Damico determined that the actual

construction costs should be used in establishing the market value because the property is new. The taxpayer identified the quality of construction as above average.

Taxpayer's exhibit #4 is a photocopy of a portion of the building plans. The purpose of this exhibit was to illustrate the building area of 80,612 square feet.

Mr. Damico presented the Board with a value indication from the income approach (ex. 2, pg 1). Summarized, this exhibit illustrates the following.

<u>Income Approach (1997 Results):</u>		<u>Per Cent</u>
Total Revenues	\$1,802,900	
Net Income or (Loss)	\$ (299,835)	
Add:		
Depreciation & Amortization	\$ 449,195	
Property Taxes	\$ 116,984	
Interest	\$ 505,224	
Less:		
Reserve for Replacement	\$ (90,145)	
Net Operating Income	\$ 681,423	37.8%
Cap Rate:		
Base Rate		11.0%
Property Tax Load		1.8%
Total		12.8%
Indicated Value	\$5,323,617	Includes land, Buildings & Personal Property
Less: Assessed Pers. Prop	\$ (682,021)	
Real Estate Value	\$4,641,596	Includes Land & Building
Less: Land Value	\$ (297,040)	
Indicated Value - Buildings	\$4,344,556	

Taxpayer's exhibit #3 is a one page excerpt from ~~A~~Hospitality Investment Survey - PKF Consulting@. Mr. Damico testified to the following with reference to this exhibit:

Capitalization Rates	Average	High	Low
Full-Service	10.9%	15.0%	8.3%
Limited-Service	11.7%	16.0%	9.0%
Resort	10.4%	13.5%	5.0%

In the taxpayer's analysis, 11.0% has been selected the most

appropriate capitalization rate for the subject property.

Mr. Damico's post-hearing submission, with reference for support for the capitalization rate, is a four page document authored by Jinneman, Kennedy, & Associated, P.S., Hospitality Consultants & Appraisers and is summarized as follows:

At your request, we completed certain consulting services regarding the selection of an appropriate capitalization rate for valuing hotels in Montana as of January 1, 1996. For our analysis, we used actual sales activity in Montana and southeast Idaho as one means of estimating an appropriate capitalization rate. We augmented the regional data with the results of several national surveys of hotel investment criteria. A discussion of each data source and the indicated return requirements are presented in the following paragraphs.

Hotel Industry Investment Surveys

Landauer Hotel Investment Outlook

...The report for the first half of 1996 indicates an average overall capitalization rate for full-service hotels of 9.75 percent, with responses ranging from 7.00 to 13.00 percent. For Limited-service hotels, an average capitalization rate of 11.55 percent was reported, with responses ranging from 10.00 to 14.00 percent.

Coopers & Lybrand/Korpacz Survey

...The 1st quarter 1996 survey indicates an average overall capitalization rate for full service hotels of 10.4 percent, 25 basis points less than the rate indicated in the 4th Quarter 1995 report, and a capitalization rate for limited-service hotels of 12.39 percent, 14 basis points less than the rate indicated in the 4th Quarter report.

HMBA Hotel Financing Survey

The hotel financing survey completed by HMBA lists regional hotel sales transactions by type of owner and hotel size. According to the year-end 1995 report, hotel sales in the Mountain and Pacific region indicated an average capitalization rate of 12.7 percent, ranging from 9.4 percent for hotels with 75 to 250 rooms to 14.5 percent for those hotels with less than 75 guestrooms.

Hospitality Investment Survey - PKF Consulting

The Hospitality Investment Survey, Published by PKF Consulting,

provides investment trends based on the expectations of buyers and sellers in lodging industry. In the second quarter of 1996, PKF's survey indicated an average capitalization rate for full-service hotels of 10.88 percent, ranging from 8.0 percent to 11.3 percent. For limited-service hotels, responses ranged from 8.5 to 14.5 percent, indicating an average overall capitalization rate of 11.76 percent.

...On a more regional level, investment in Montana has historically been perceived to carry a somewhat greater degree of risk than would be associated with investment in other areas of the United States. This greater risk is primarily the result of lower investor interest in Montana, Montana's remote location, and overbuilding of hotel properties, including the Missoula market. Accordingly, we would consider an appropriate capitalization rate to be slightly greater than those indicated by national sales data.

Comparable Hotel Sale Properties

Comparable hotel sales in Montana and southeast Idaho were researched and analyzed to provide a more regional indication.

All these sales were researched and analyzed while our firm was completing appraisals of hotels in Montana. These sales were confirmed with the broker, the seller, or the buyer. Capitalization rates were computed by dividing the net operating income, after deduction of an appropriate property management fee and capital replacement reserve, by the sale price. Additional details of these sales are available from our office. The overall capitalization rates derived from the unadjusted comparable sales are summarized in the following table.

Table 2
Summary Of Comparable Hotel Sale Indicators

Property Name	Location	Year Built	Sale Date	Cap Rate
<i>Full-Service Hotel Sales</i>				
Ponderosa Inn	Great Falls, Montana	1969	Jun-91	10.9%
Best Western Canyon Springs	Twin Falls, Idaho	1973/1984	Aug-95	14.4%
Townhouse Inn	Great Falls, Montana	1972/1984	Feb-92	13.3%
Best Western War Bonnet Inn	Butte, Montana	1973/1977	Mar-93	11.2%
Best Western Colonial Inn	Helena, Montana	1970/1986	Apr-96	11.3%
Quality Inn	Pocatello, Idaho	1978	Mar-94	16.0%
<i>Limited-Service Hotel Sales</i>				
Super 8 Motel	Miles City, Montana	1978	Feb-92	12.4%
Super 8 Motel	Glendive, Montana	1978/1986	Mar-93	11.8%
Super 8 Motel	Whitefish, Montana	1989	Aug-93	15.0%
Best Western AmeriTel Inn	Idaho Falls, Idaho	1991	Jun-96	13.7%

The overall capitalization rates extracted from the above sales data indicate a range of unadjusted capitalization rates from 10.9 to 16.9 percent. These sales include both limited and full-service hotels and do not include sales of distressed

properties. These capitalization rates are supported by the industry surveys, which indicate average overall capitalization rates from 9.75 to 12.70 percent, but also reflect the greater risk associated with the hotel industry in Montana.

Hotels are a unique type of real estate investment that carry risks and benefits not found in many other types of real estate investment. Unique characteristics of hotels include:

- , A large amount of personal property (furniture, fixtures, and equipment) necessary for operation.
- , The retail nature of operation, including the need to re-sell rooms on a daily basis and the labor intensity of the business.
- , Rapid functional obsolescence due to increased market segmentation in the industry.
- , Susceptibility to external factors, such as changes in the market area conditions or modes of travel, which can immediately affect the operating performance of a hotel.
- , Specialized nature of a hotel, which limits the number of potential buyers.
- , Potential for large profits once fixed costs are covered.
- , Because guestrooms are re-sold on a daily basis, changes in market conditions affect the value of hotels more rapidly than most other types of real estate. Accordingly, more risk is associated with the hotel investment than with other real estate investments, and higher capitalization rates are required. Based on investment surveys completed by Cushman & Wakefield and Dupre & Scott, typical capitalization rates for office properties in January 1996 averaged 9.0 percent, while typical capitalization rates for apartment properties averaged 8.3% percent. These rates are approximately 200 to 850 basis points less than those indicated by the actual comparable hotel sale data, demonstrating the additional risk associated with hotel investments in Montana.

DOR-S CONTENTIONS

The DORs market value of \$5,633,600 for the improvements was determined by the cost approach to value. Mr. McKenna testified that, when the DOR is in the process of establishing their cost tables, builders and contractors are contacted to obtain actual construction costs for various projects across the State. Mr. McKenna stated that Mr. Damico

presented the DOR with the construction costs for the subject property, but the DOR had a high confidence level in its own established costs; therefore, in the final determination of value, the DOR considered its own costs. DOR exhibit A is a copy of the property record card and illustrates the following with respect to the improvements:

Structure

- , Year built - 1996
- , Number of units - 130
- , Quality grade - Good
- , Building area - 81,208 square feet
- , Physical condition - 4 (good)
- , Functional utility - 2 (fair)
- , Percent good - 97% (accumulated depreciation - 3%)
- , Economic Condition Factor (ECF) - 105%

Other Building and Yard Improvements

, Paving (asphalt) - 87,336 square feet - \$100,700
, Paving (concrete) - 8,226 square feet - \$13,100
, Swimming pool - \$30,600
, whirlpool/hot tub - \$8,300
, Physical condition - 3 (average)
, Functional utility - 2 (fair)
, Percent good - 96% (accumulated depreciation - 4%)

DOR exhibit B (PT-1997-85) is a four page document which the DOR incorporate in appeals PT-1997-82, 84, 85 and 86. Mr. Fairbanks stated created by DOR appraiser, Sue Hoell. In summary this exhibit illustrates

FIVE LARGE VERY GOOD QUALITY MOTELS - 1997				
Property	Holiday Inn Parkside	Best Western Grant Creek	Ruby's Reserve Street Inn	Holiday Express
Year Built	1984	1996	1981	1995
Building Area	136,960	81,208	67,020	42,700
# of Rooms	200	126	127	95
Room Rate	\$56	\$63	?	\$50
Occupancy	71%	60%	?	50%
Room Income	\$2,918,832	\$1,738,422	\$1,752,563	\$953,000
Telephone Income	\$17,479	\$6,419	\$0	\$3,900
Other	\$67,730	\$0	\$0	\$14,000

Total Income	\$3,004,041	\$1,744,841	\$1,752,563	\$972,
Total Expenses	\$2,366,591	\$1,180,887	\$1,430,583	\$572,
Net Income	\$637,450	\$563,954	\$321,980	\$399,
Value @ 9.5%	\$6,710,000	\$5,936,358	\$3,389,263	\$4,208
Value @ 13%	\$4,553,214	\$4,338,108	\$2,476,769	\$3,075
Pers Property(PP)	\$317,862	\$682,521	\$183,658	
Value 1 Less PP	\$6,392,138	\$5,253,837	\$3,205,605	\$4,208
Value 2 Less PP	\$4,235,352	\$3,655,587	\$2,293,111	\$3,075
Estm Rpl Cst Less Depr	\$7,097,782	\$5,930,640	\$3,570,166	\$3,415
Assessed Value	I \$6,823,800	C \$5,930,640	I \$3,470,500	C \$3,4
Value Per Room	\$21,177	\$29,013	\$18,056	\$32,

Mr. McKenna testified the cost approach to value is most applicable when the properties are new and little depreciation need be applied.

The DOR modified the cost figures by an Economic Condition Factor (ECF) of 105%. Mr. Fairbanks defined that the ECF ~~A~~compares cost figures with prevailing market evidence. So it's suggesting that the depreciated cost in this neighborhood, is 5% lower than indicated market values@.

An income approach to value was determined for the subject property but, since this property was newly constructed, the DOR employed the cost approach. The DOR's value generated from the income approach was \$5,626,400 which is the total value of the land and improvements. DOR's exhibit C was the value determination from the income approach and in summary illustrates the following:

Income Portion

Base Rate	=	\$55.00
Market Type (Commer)	x	1.50
Quality Type (Good)	x	1.10
Adjusted Base Rate	=	\$90.75
x number units	x	130
x number days	x	365
Potential Gross Income	=	\$4,306,088
Occupancy Predicted	x	60%
Effective Gross Income	=	\$2,583,652
Expenses 75% of Gross Income	=	\$1,937,739
Total Expenses	=	\$1,937,739
Net Income	=	\$645,913

Income Capitalization

Equity Ratio 1.00 x cash on cash	0.095 = 0.095
Effective Tax Rate	= 0.0198
Total Capitalization Rate	0.1148
Net Income 645,913 @ 0.1148	
Value, Income Approach	\$5,626,400
Cost	\$5,930,640
Income	\$5,626,400
Ratio	-5%

Mr. Fairbanks indicated that, when the income models were created, the income was adjusted to reflect the portion attributable to personal property, (i.e. beds, televisions, etc.). He stated that nightly rent or room rate was discounted to reflect this amount.

DOR's exhibit B is a compilation of motel/hotel properties that have sold along with the DOR's market value indications for this series of appeals. This exhibit is summarized as follows:

Comparable Sales						
	Yr. Built	Grade	# Units	Sale Date	Sale Amount	Per Unit
Sale #1	1982	A+	115	9/95	\$3,488,077	\$30,331
Sale #2	1981	A	117	4/94	\$3,740,000	\$31,966
Sale #3	1995	A+	52	9/95	\$1,900,000	\$36,538
Sale #4 *	1978	G	220	4/98	\$9,000,000	\$40,909
Sale #5 *	1972	A+	124	2/98	\$7,140,000	\$57,581
Sale #6 *	1970	G	149	4/96	\$9,150,350	\$61,412
Properties Under Appeal						
	Yr. Built	Grade	# Units		Appraised Value	Per Unit
Ruby s (97-86)	1988	A+	132	N/A	\$3,470,500	\$26,292
Holiday Inn Parkside (97-82)	1984	G+	200	N/A	\$6,823,800	\$34,119
Holiday Inn Express (97-83)	1996	G-	97	N/A	\$3,415,714	\$35,214

Grant Creek Inn (97-84)	1996	G	130	N/A	\$5,930,640	\$45,620
Hampton Inn (97-85)	1996	G	60	N/A	\$2,760,300	\$46,005
* full service facility						

Mr. Fairbanks testified the DOR does not market model commercial properties to determine market value. Exhibit B was presented to illustrate the comparison of sold properties on a price per unit (sale price/number of rooms) with the DOR's per unit value of the properties under appeal (DOR market value/number of rooms).

Mr Fairbanks testified that daily rates and occupancy rates are not difficult to obtain, but net operating income from properties which have sold is not so easily ascertained; therefore, the DOR will create or normalize the income and expenses in order to establish the net operating income. This net operating income is then used to develop a capitalization rate.

The DOR's post-hearing submission illustrates the following in support of the 9.5% capitalization rate before applying the effective tax rate:

MARKET-BASED CAP RATES FOR MISSOULA COUNTY MOTELS					
Taken from RTCs and income/expense reports					
Property	Sale #1	Sale #2	Sale #3	Sale #4	Sale #5
Sale Date	September 95	April 95	April 93	May 93	February 93

Sale Price	\$1,900,000	\$325,000	\$500,000	\$347,500	\$170,000
Net Income	\$180,500	\$29,920	\$47,158	\$35,000	\$16,660
Cap Rate	9.50%	9.21%	9.43%	10.00%	9.80%

DISCUSSION

The Administrative Rules of Montana (ARM) provides that the DOR establish market value from the income approach.

ARM, 42.20.107 Valuation Methods For Commercial Properties.

(1) When determining the market value of commercial properties, other than industrial properties, department appraisers will consider, if the necessary information is available, an income approach valuation.

(2) If the department is not able to develop an income model with a valid capitalization rate based on the stratified direct market analysis method, the band-of-investment method or collect sound income and expense data, the final value chosen for ad valorem tax purposes will be based on the cost approach or; if appropriate, the market approach to value. The final valuation is that which most accurately estimates market value. (emphasis added)

ARM, 42.20.108 Income Approach.

(1) The income approach is based on the theory that the market value of income producing property is related to the amount, duration, and certainty of its income producing capacity. The formula used by the department to estimate the market value of income producing property through application of the income approach to value is $V = I/R$ where:

(a) $Av@$ is the value of the property to be determined by the department;

(b) $AI@$ is the typical property net income for the type of properties being appraised; and

(c) $AR@$ is the capitalization rate determined by the department as provided in ARM 42.20.109. (emphasis supplied)

ARM, 42.20.109 Capitalization Rates.

(1) When using the income approach, the department will develop overall capitalization rates which may be according to use type, location, and age of improvements. Rates will be determined by dividing the net operating income of each property in the group by its corresponding valid sale price.

The overall rate chosen for each group is the median of the rates in that group. The final rate must include an effective tax rate. (emphasis added)

(2)(a) If there are insufficient sales to implement the provisions of ARM 42.20.109 (1), the department will consider using a yield capitalization rate. The rate shall include a return of investment (recapture), a return on investment (discount), and an effective tax rate. The discount is developed using a band-of-investment for types of commercial property. The band-of-investment method considers the interest rate that financial institutions lend on mortgages and the expected rate of return an average investor expects to receive on their equity. This method considers the actual mortgage rates and terms prevailing for individual types of property.

(b) A straight-line recapture rate and effective tax rate will be added to the discount rate to determine the yield capitalization rate.

The taxpayer's net operating income (NOI) from exhibit #2 is \$681,423 and the DOR's NOI from exhibit C is \$645,913. The major disparity between the party's income approaches lies with the determination of an appropriate capitalization rate. The taxpayer capitalized the NOI at 12.8% (11.0% - base rate + 1.8% - effective tax rate) and the DOR capitalized the NOI at 11.48% (9.5% + 1.98% effective tax rate). The Board requested that each party provide additional support for their respective capitalization rates through a post-hearing submission. The taxpayer's support for its capitalization rate was provided by JK & Associates, Hospitality Consultants & Appraisers. The DOR's support for its capitalization rate was provided by five additional motel sales. The post-hearing submissions have been submitted for the immediate appeal and appeals PT-1997-82, 83, 85 & 86. The

appeals are for limited-service motels as well as full service motels. The Board notes that capitalization rates may vary depending upon the type of motel property along with all the additional components that affect value, i.e. age, condition, location, etc.

The DOR testified, when determining the capitalization rate from properties that have sold, the NOI's for those sales were created rather than using properties' actual NOI's at the time of sale. It is the Board's opinion that an actual NOI should be used if possible when establishing a capitalization rate. The Board realizes that adjustments may need to be made to the reported NOI, i.e. taxes, management, reserves for replacement, etc. It is the Board's opinion that simply creating an NOI does not reflect an actual capitalization rate for the various sales. In addition, the Board was not presented evidence explaining how the various NOI's were created.

The DOR adjusts the value of the improvements as determined by the cost approach by an ~~A~~Economic Condition Factor[®] (ECF). The ECF is a market adjustment factor. The International Association of Assessing Officers (IAAO) states:

Market adjustment factors are often required to adjust values obtained from the cost approach to the market. These adjustments should be applied by type of property and area based on sales ratio studies or other market analyses. Accurate cost schedules, condition ratings, and depreciation schedules will

minimize the need for market adjustment factors.
(IAAO, 1990, Property Appraisal and Assessment
Administration, pages 311-312)(Emphasis applied)

An ECF for a neighborhood is derived from sales; but there was no evidence or testimony from the DOR to indicate the ECF of 105% that was applied was developed from sales of properties of the same type as the subject property. It was testified that the ECF was determined from sales of all commercial property.

Mr. Fairbanks testified, **A**...it might be much more appropriate to specifically identify an ECF for specific occupancy.@ Mr. Fairbanks further testified, **AI** don't think we had enough sales to identify an ECF for occupancy.@

The DOR presented the Board with six motel property sales.(exhibit B) This exhibit compares the DOR's value indications for the five motel properties represented by Mr. Damico with six motel property sales. The properties vary in comparability (i.e., full-service, limited service, age, size, location, etc). The DOR presented this exhibit to illustrate what motel properties are selling for on a price per motel room.

Motel properties can be viewed as having a **A**going-concern value@, defined in the Appraisal of Real Estate, 11th Edition, as:

Going-concern value is the value of a proven property operation. It includes the incremental value associated with the business concern, which is distinct from the value of the real estate. Going-

concern value includes an intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labor, equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. Going-concern value refers to the total value of a property, including both real property and intangible personal property attributed to business value.

Going-concern appraisals are commonly conducted for hotels and motels, restaurants, bowling alleys, industrial enterprises, retail stores, shopping centers, and similar properties. For these properties, the physical real estate assets are integral parts of an ongoing business. It may be difficult to separate the market value of the land and the improvements from the total value of the business, but such division of reality and nonreality components of value is often required by federal regulations. (emphasis added)

The Board realizes the sales illustrated and used by the DOR for comparison purposes may, in fact, reflect the inclusion of ~~A~~going-concern values and the DOR is appraising for ad valorem purposes. The DOR did not establish the market value for the subject property by the sales comparison approach to value, but the sales illustrated on exhibit B would need to be adjusted for the inclusion of personal property, excess land, business inventory, liquor/gaming license and intangibles that may have been included in the transaction.

The subject property was built during 1995 and 1996; therefore, it is new construction for the current appraisal cycle. The Board agrees with both parties that the cost approach to value is most effective in determining market value for new properties. The Appraisal of Real Estate, 11th

Edition, states:

~~A~~The cost approach is based on the understanding that market participants relate value to cost. In the cost approach, the value of a property is derived by adding the estimated value of the land to the current cost of constructing a reproduction or replacement for the improvements and then subtracting the amount of depreciation (i.e., deterioration and obsolescence) in the structures from all causes. Entrepreneurial profit may be included in the value indication. This approach is particularly useful in valuing new or nearly new improvements and properties that are not frequently exchanged in the market.@ (emphasis added)

Both parties presented the Board with market value indications for the improvements from the cost approach. In addition, both parties presented the Board with market value indications from the income approach to value to support their respective value indications from the cost approach. The DOR's value indication from the cost approach was developed from the DOR's cost tables.

The DOR stated that, within the income model for motel properties, the income has been reduced for the existence of the motels' personal property. The taxpayer's requested value was presented as the actual construction cost. The taxpayer's income approach indication was developed from the actual 1996 & 1997 operating statements. By using the actual income and expense data for a property that has only been in operation for a year and a half at the time the appeal was filed, it might be the best indicator of market value.

Mr. McKenna stated in the post-hearing submission:

AThe courts have ruled (Western Airlines Versus Michonovich 149 Montana, page 347 (1967) that the burden of disproving the DOR's valuation rests with the appellant, and that there is a presumption of correctness in the DOR's appraisal.@ This statement is correct but incomplete. The court's decision further stated, A...the taxing agency should bear a certain burden of showing the propriety of their action.@"

Mr. McKenna also stated in his post-hearing submission: AIndeed, Mr. Damico testified under oath before the Missoula County Tax Appeals Board that, after considerable review, the properties were not properly appraised and should be valued at one level, and then testified under oath to STAB that, after considerable review, the properties were not properly appraised and should be valued at a higher value. The DOR's valuation has never wavered.@"

This Board has always dealt with and allowed a modification of the values requested by the taxpayers. There are any number of reasons that could warrant such a modification following an appearance before a local tax appeal board. A change in the requested value does not constitute an inconsistency or a contradiction of prior testimony that could be seen as an unfair surprise to the DOR, particularly in this case, since the requested value was increased from that requested by the taxpayer before the local tax appeal board.

Mr. McKenna was provided the opportunity of examination of Mr. Damico and his exhibits and to draw from those the inconsistencies Mr. McKenna may have believed existed. It is unclear why that issue was raised in a post-hearing submission.

In Department of Revenue v. BN Inc., 169 Mont. 202, A..while STAB reviewed the assessment (as it may under section 84-708(3), R.C.M. 1947), augmenting the record so it might better perform its duty, as stated in section 84-709:

A *** to affirm, reverse or modify any decisionappealable to the state tax appeal board **@.

To perform this function, STAB may have a completede novo hearing, for the infrequent case in which the board is of the opinion that if should examine all of the record of the Department, and additional evidence, on a firsthand basis, so as to reach a fair, just and equitable holding..@ (emphasis added)

Based on the evidence and testimony presented to the Board, the market value for the subject improvements, Grant Creek Inn, shall be the actual construction costs of \$4,664,186 as presented by the taxpayer.

CONCLUSIONS OF LAW

1. The State Tax Appeal Board has jurisdiction over this matter. '15-2-301 MCA.

2. '15-8-111, MCA. Assessment - market value

standard - exceptions. (1) All taxable property must be assessed at 100% of its market value except as otherwise provided.

3. **15-2-301, MCA, Appeal of county tax appeal board decisions.** (4) In connection with any appeal under this section, the state board is not bound by common law and statutory rules of evidence or rules of discovery and may affirm, reverse, or modify any decision.

4. **Western Airlines, Inc. v. Catherine J. Michunovich, et al, 149 Mont. 347.428 P.2d 3.(1967).**

5. **Department of Revenue v. BN Inc., 169 Mont. 202.**

6. Evidence and testimony in PT-1997-82, PT-1997-83, PT-1997-84 & PT-1997-86.

7. The appeal of the taxpayer is hereby granted and the decision of the Missoula County Tax Appeal Board is reversed.

ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject improvements shall be entered on the tax rolls of Missoula County by the County Assessor at the 1997 tax year value of \$4,664,186.

Dated this 23rd of December, 1998.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

PATRICK E. McKELVEY, Chairman

GREGORY A. THORNQUIST, Member

LINDA L. VAUGHEY, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.